


Handout for 'Sale of Business Financing and SBA' Training Class
Via Ready Talk – October 20, 2004
Presented by Tony Wagner

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BUSINESS VALUATION

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AUTHORITY

- CFR SECTION 120.202
- SOP 50-10 PAGES 193-199
- SOP 50-13 PAGES 187-193
- SBA POLICY NOTICE 5000-677
- SBA POLICY NOTICE 5000-693
- SBA POLICY NOTICE 5000-764

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DOCUMENTATION

- F/S FOR THE PRIOR 3 YEARS SIGNED AND DATED
- CURRENT F/S SIGNED AND DATED
 - INCOME STATEMENT AND BALANCE SHEET
- BUY-SELL AGREEMENT*
- LENDER'S BUSINESS VALUATION*
- RELATIONSHIP OF BUYER AND SELLER*
- JUSTIFICATION OF THE SALE*
- WELL DOCUMENTED WITH SUBSTANTIAL ANALYSIS

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BUY-SELL AGREEMENT

- WRITTEN AGREEMENT
 - INTENT TO SELL
 - HOPEFULLY SIGNED
- SALE PRICE
- ASSETS TRANSFERRED
- LIABILITIES ASSUMED
- SELLER FINANCING
 - RATE, TERM, SECURITY
- CLOSING DATE
- ETC.

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LENDER'S VALUATION

- WRITTEN AND RETAINED
- MUST INCLUDE 2 METHODS
- SUPPORT/JUSTIFY (PROVIDE THE SOURCE)
 - CAP RATE
 - OFFICER'S COMP
 - ADJUSTMENTS TO EARNINGS
 - MULTIPLIER USED
- INCLUDE IN PACKAGE TO SBA IF REGULAR 7(A)
- SYNOPSIS ATTACHED IF SBAExpress

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CLOSE FAMILY MEMBERS

- SALE BETWEEN
 - SPOUSES
 - SIBLINGS
 - PARENT
 - CHILD
- PROFESSIONAL VALUATION REQUIRED
- TAX RETURNS IN FILE PRIOR TO APPROVAL*

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JUSTIFICATION OF THE SALE

- SALE MUST BE ARMS-LENGTH
- DISCUSS THE REASON FOR THE SALE
- SALE MUST BENEFIT THE BUSINESS
- BUYER'S PRIOR EXPERIENCE WITH THE BUSINESS
- DISCUSS THE BUSINESS TREND
 - FAILING BUSINESS
 - STABLE OR GROWING BUSINESS

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PRIOR SALE

- WITHIN 36 MONTHS
 - TWO APPRAISALS REQUIRED
 - OR
 - APPRAISAL AND REVIEW BY SECOND APPRAISER
 - OR
 - APPRAISAL AND SITE VISIT
 - BY SENIOR BANK MANAGEMENT
 - DOCUMENT DATE OF SITE VISIT
 - DOCUMENT ITEMS REVIEWED

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PARTIAL SALE

- NON-OWNER MUST BUY 100%
- NON-OWNER CAN NEVER BUY PART OF AN EXISTING OWNER'S INTEREST
- EXISTING OWNER CAN BUY OUT OTHER OWNERS
 - MUST RETAIN PROPORTIONAL OWNERSHIP
 - 1/3, 1/3, 1/3 BEFORE AND 1/2, 1/2 AFTER
- GUARANTEE OF ALL 20% OR MORE OWNERS IS REQUIRED

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ACCEPTABLE METHODS

- GROSS REVENUE MULTIPLIER
- ADJUSTED BOOK VALUE
- DISCOUNTED FUTURE EARNINGS
- CAPITALIZED ADJUSTED EARNINGS
- CASH FLOW
- OTHER GENERALLY ACCEPTED VALUATION METHODS

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GROSS REVENUE MULTIPLIER

- SALES ARE THE BASIS FOR VALUE
- SALES TIMES AN INDUSTRY MULTIPLIER ESTABLISHES VALUE
- GENERALLY PRIOR 12 MONTHS
- SHOULD BE A PUBLISHED AND RELIABLE SOURCE
 - SOURCE OF THE MULTIPLIER
- OF QUESTIONABLE VALUE

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ADJUSTED BOOK VALUE

- VALUE OF THE PHYSICAL ASSETS DETERMINES BUSINESS VALUE
- INCREASE THE BOOK VALUE OF THE ASSETS TO CURRENT APPRAISED INPLACE VALUE
- LESS ANY LIABILITIES ASSUMED
- ASSUMES NO GOODWILL VALUE OR BOOK OF BUSINESS VALUE (EXCEPT PURCHASED GOODWILL)
 - APPRAISALS FOR THE REAL ESTATE AND EQUIPMENT
 - REVIEW OF INVENTORY AND ACCOUNTS RECEIVABLE

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CASH FLOW METHOD

- CASH FLOW IS THE BASIS OF VALUE
- PROVIDE SUFFICIENT CASH FLOW TO
 - PAY ALL BUSINESS EXPENSES
 - SERVICE THE PROFORMA DEBT
 - ADEQUATELY REWARD MANAGEMENT
 - INCLUDING INCOME AND SELF EMPLOYMENT TAXES
 - REPLACE M & E WHEN NECESSARY

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DISCOUNTED FUTURE EARNINGS METHOD

- FUTURE EARNINGS IS BASIS FOR VALUE
- MUST BE BASED ON EXISTING OPERATIONS
- MUST USE REASONABLE
 - GROWTH RATE (historical)
 - GROSS PROFIT MARGIN (historical)
 - NET PROFIT MARGIN (historical)

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CAPITALIZED ADJUSTED EARNINGS METHOD

- PRIOR EARNINGS IS BASIS FOR VALUE
- ISSUES
 - CAP RATE
 - OFFICERS COMPENSATION
 - ADJUSTMENTS TO EARNINGS

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ADJUSTMENTS TO EARNINGS

- SELLER'S OFFICER COMPENSATION
- INTEREST
- DEPRECIATION/REPLACEMENT OF M & E
- RENT
- BUYER'S OFFICER COMPENSATION
- ABNORMAL MARKET CONDITIONS
 - PAST AND FUTURE
- OTHER

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OFFICER COMPENSATION

- SELLER'S OFFICER COMPENSATION
- SELLER SALARY/DRAW PLUS
 - CASH PLUS
 - PERSONAL AUTO
 - LIFE INSURANCE
 - OTHER

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OFFICER COMPENSATION


- WHAT IT WOULD COST TO HIRE A PROFESSIONAL TO MANAGE THE BUSINESS
- BUYER'S ABILITY TO LIVE ON A SMALLER SALARY OR REQUIREMENT FOR A LARGER SALARY DOES NOT AFFECT VALUE
- U. S. DEPT. OF LABOR WEB-SITE
- <http://stats.bls.gov/>
- <http://www.salary.com/>
- SOURCE OF THE OFFICER COMP. YOU USE

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<http://stats.bls.gov/> _____

<http://www.salary.com/> _____

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MARKET COMPENSATION

- MANAGEMENT OCCUPATIONS TOP
 - Per Bureau of Labor Statistics website
 - Wages not total compensation

	2002	2005
■ GENERAL MANAGER	\$70,930	\$73,313
■ MARKETING MANAGER	\$80,290	\$87,516
■ SALES MANAGER	\$76,340	\$83,106
■ CONSTRUCTION MANAGER	\$67,860	\$73,967
■ FOOD SERVICE MANAGER	\$35,350	\$38,532
■ LODGING MANAGER	\$35,980	\$39,218

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BUSINESS CAP RATE

- SOP 50-13 ESTABLISHES A RANGE OF 15 – 30% FOR SMALL BUSINESSES
- JAMES H SCHILTZ "BUSINESS VALUATION REVIEW" ESTABLISHES A RANGE OF 16% TO 36%
- THE GREATER THE RISK THE LARGER THE CAP RATE
- SOP 50-13 DOESN'T ESTABLISH A RATE FOR BUSINESS REAL ESTATE

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REAL ESTATE CAP RATE

- SOP 50-13 DOES NOT ESTABLISH A CAP RATE FOR REAL ESTATE
- PER AL DASSOW OF CLIFTON GUNDERSON 8-12 %
 - 8%, NEWER, WELL LOCATED, LOW MAINTENANCE, MULTI USE, EASILY RENTABLE, EASILY SALEABLE, RESIDENTIAL, .
 - 12%, OLDER POORLY LOCATED, HIGH MAINTENANCE, SINGLE USE, NOT EASILY RENTABLE, NOT EASILY SALEABLE, COMMERCIAL

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PICKING THE CAP RATE

- SCHILTZ BASES RISK ON
 - PROFIT
 - COMPETITION
 - BARRIERS TO ENTRY
 - DEPT OF MANAGEMENT
 - TRADE POSITION

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COLLATERAL RISK

- RISK BASED ON LIQUIDATION VALUE OF THE COLLATERAL
 - GOODWILL NO RECOVERY HIGHEST RISK
30-36% CAP RATE
 - INVENTORY LIMITED RECOVERY MODERATE RISK
25% CAP RATE
 - M & E REASONABLE RECOVERY
15 - 20% CAP RATE

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DEPRECIATION

- DEPRECIATION ON REAL ESTATE
 - **GENERALLY AVAILABLE TO SERVICE DEBT**
- DEPRECIATION ON M & E
 - **GENERALLY NOT AVAILABLE TO SERVICE DEBT**
- REPLACING M & E
 - **REPLACEMENT MAY EXCEEDS DEPRECIATION**

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OTHER ISSUES

- SELLER'S FINANCING
 - STANDBY OR SUBORDINATE
 - EXTEND TERMS *
- NON-COMPETE
 - LIMITED TERM AND DISTANCE ARE GENERALLY ENFORCEABLE
- TRANSITIONAL MANAGEMENT
 - ADDS TO VALUE
 - ADDS TO LENDER/SBA COMFORT

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PROPERTY BEING SOLD

- MOST OF THE METHODS ASSUME AN ASSET ONLY SALE
 - ALL BUSINESS ASSETS EXCEPT
 - CASH
 - ACCOUNTS
 - REAL ESTATE
 - DEBT FREE SALE
 - NO ACCOUNTS PAYABLE ASSUMED
 - NO ADDITIONAL W/C NEEDS

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PROPERTY BEING SOLD

- ADJUST FOR
 - DEBT OR LIABILITIES BEING ASSUMED
 - REAL ESTATE ?
 - ADDITIONAL FINANCING NEEDS
 - EQUIPMENT PURCHASES IF NOT IN DEPRECIATION/ M&E REPLACEMENT

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GAS IT UP C-STORE

- SALE PRICE \$640,000
- INCLUDES
 - REAL ESTATE \$200,000
 - ALL M&E/F&F \$250,000
 - INVENTORY \$40,000
 - GOODWILL \$150,000
 - \$540,000 in debt and \$100,000 in Equity
- LIABILITIES ASSUMED NONE

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GAS IT UP C-STORE

- ADJUSTMENTS TO PURCHASE PRICE
 - CASH?
 - ACCOUNTS?
 - REAL ESTATE?
 - DEBT/LIABILITIES ASSUMED?
 - ADDITIONAL FINANCING NEEDS?
 - ADDITIONAL M&E NEEDS

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GAS IT UP C-STORE

- ADJUSTMENTS TO THE INCOME STATEMENT
 - SELLER'S SALARY/BUYER'S SALARY
 - INTEREST
 - DEPRECIATION
 - RENT
 - NON-RECURRING ITEMS
 - ABNORMAL MARKET CONDITIONS
 - REPLACEMENT OF M&E

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GAS IT UP C-STORE

- GROSS REVENUE MULTIPLIER
- TOM WEST "BUSINESS REFERENCE GUIDE"
- .25 x annual sales plus real estate and M & E

■ .25	X	\$1,625,097	=	\$406,274
■ Plus Real estate and M & E				<u>\$450,000</u>
		Total value		\$956,274

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GAS IT UP C-STORE

- ADJUSTED BOOK VALUE

■ Real Estate	\$200,000
■ M & E	\$250,000
■ Inventory	<u>\$40,000</u>
■ Total	\$490,000

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CAPITALIZED ADJUSTED EARNINGS

- BUSINESS CAP RATE PER SCHILTZ

■ CATAGORY 3	21-25%
■ COMMERICAL REAL ESTATE	10%

- WEIGHTED CAP RATE

■ BUSINESS	21% x 440,000/640,000 = 14,438
■ REAL ESTATE	10% x 200,000/640,000 = <u>3.125%</u>
■ TOTAL	17.563%

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	2001	2002	2003
Net Profit	48,551	53,821	40,020
Seller's Comp	19,950	19,800	12,600
Seller's Interest	19,576	16,440	14,222
Seller's Dep.	7,876	4,994	4,904
Reasonable Comp.	(40,000)	(40,000)	(40,000)
Repl. M & E	(5,000)	(5,000)	(5,000)
TOTAL	50,953	50,055	26,746
Weighting	x 1/6	x 1/3	x 1/2
Weighted Adj. Earn	8,492	16,685	13,373
Total weight \$38,550 / 17.6% = \$219,034			

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	2002	2003
NET PROFIT	53,821	40,020
SELLER'S COMP.	19,800	12,600
SELLER'S INTEREST	16,440	14,220
SELLER'S DEPRECIATION	4,994	4,904
REASONABLE OWNER'S COMP	(40,000)	(40,000)
REPLACE OF M & E	(5,000)	(5,000)
TAXES	(6,000)	(4,000)
CASH FLOW AVAILABLE FOR D/S	44,055	22,744
PROFORMA D/S	48,341	48,341
EXCESS SHORTFALL	(4,286)	(25,597)


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CASH FLOW 2	
■ Value using 2003 cash flow	
■ \$22,744/yr will service	\$244,559 of debt
■ 20 years @ 7%	
■ Plus	\$100,000 of equity
■ Value	\$344,559
■ Value using 2002 cash flow	
■ \$44,055/yr will service	\$473,710 of debt
■ 20 years @ 7%	
■ Plus	\$100,000 of equity
■ Value	\$573,710

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 SUMMARY	
■ GROSS REVENUE MULTIPLIER	\$956,274
■ ADJUSTED BOOK VALUE	\$490,000
■ CASH FLOW (2003 cash flow)	\$344,559
■ CASH FLOW (2002 cash flow)	\$573,710
■ CASH FLOW (average)	\$459,135
■ CAPITALIZED ADJ. EARNINGS	\$219,034
■ Average Of above \$496,715	
■ SUMMARY OF VALUE	\$500,000
■ SALE PRICE	\$640,000
■ EXCESS SALE PRICE OVER VALUE	\$140,000

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